Responsible Investment Association Australasia

Green bonds and other responsible investment products – Consultation by the Financial Markets Authority NZ: RIAA submission

October 2019

About RIAA and our members

RIAA is dedicated to ensuring capital is aligned with achieving a healthy society, environment and economy and champions responsible investing and a sustainable financial system in Australia and New Zealand.

With over 260 members managing more than $AU9 trillion in assets globally, RIAA is the largest and most active network of people and organisations engaged in responsible, ethical and impact investing across New Zealand and Australia.

RIAA's membership includes super funds, fund managers, KiwiSaver providers, banks, consultants, researchers, brokers, impact investors, property managers, community trusts, foundations, faith-based groups, financial advisers and individuals. In New Zealand, we currently have 40 organisational members, including 13 KiwiSaver providers.

RIAA achieves its mission through:

- providing a strong voice for responsible investors in the region, including influencing policy and regulation to support long-term responsible investment and sustainable capital markets
- delivering tools for investors and consumers to better understand and navigate towards responsible investment products and advice including the online consumer tool Responsible Returns
- setting standards of leading practices in responsible investment, informed and consistent with our global networks and peers, and embedding these in our work program including the world's first and longest running fund Certification Program
- supporting continuous improvement in responsible investment practice among members and the broader industry through education, benchmarking and promotion of best practice and innovation
- acting as a hub for our members, the broader industry and stakeholders to build capacity, knowledge and collective impact
- continuing to be a trusted source of information about responsible investment.

Importantly, RIAA also runs the world's longest running responsible investment Certification Program, with 15 years of experience reviewing, assessment and auditing the practices of responsible investment as they are implemented by investment managers. RIAA has 160 investment products Certified as meeting high standards of implementation of responsible investment practices, including a total of 16 KiwiSaver products (one default and 15 others) from 4 providers.[1] In addition to this, RIAA is deeply connected to international developments in the area of standards and best practices in responsible investment, and the evidence base that is underpinning the growth and impact of the industry.

1 RIAA members with registered KiwiSaver products: Pathfinder, Pie Funds, AMP (via AMP Capital), ANZ Investments, Booster, Harbour, KiwiWealth, Medical Assurance Society, Mercer, Nikko Asset Management, NZ Funds, Milford, NZ Anglican Church Pension Board

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For nearly 20 years RIAA has defined, mapped and measured responsible investment in the region, and delivered annual benchmarking research defining the size and growth of the industry.

This submission draws on that experience in the local market, informed by our global networks, and provides RIAA's input to this important consultation.

1. *What do you consider to be the key features that make a financial product green, ethical, or otherwise responsible?*

Categories of responsible and ethical investment strategies have been consistently described and defined globally through the work of the Global Sustainable Investment Alliance (GSIA) since 2012.[2] The GSIA is made up of the largest regional sustainable and responsible investment industry bodies, including the Responsible Investment Association Australasia, with a combined membership of over 1000 investment organisations and coverage across the largest financial markets of north America, Asia, Europe, UK and Australasia. This early work on definitions was then integrated into the UN supported Principles of Responsible Investment, whereby the PRI incorporated these same definitions within their own reporting frameworks. There remains an agreement at a global level between the PRI and GSIA to work collaboratively towards ongoing agreed definitions across different approaches to responsible investment. At the outset, it is important to note that the FMA should, wherever possible, remain aligned to globally agreed definitions. This is especially important due to the global nature of capital markets, whereby New Zealand investors will be investing their responsible investment products into global funds and products. As far as possible, a consistent approach across markets is preferable from a New Zealand market perspective.

It is in keeping with these globally agreed definitions of responsible investment strategies that RIAA operates, researches, benchmarks and certifies investment products across Australasia, having done so for 19 years. With those definitions as our starting point, RIAA has then established globally consistent standards that we embed within our work program, specifically within our research and certification work. For a summary of these definitions in a table format, see our Spectrum of Responsible Investment diagram.[3]

RIAA's RI Certification Program[4] (operating across New Zealand and Australia since 2005) is the most established source of standards in responsible and ethical investing in our region, informed by and consistent with global standards, shaped by comprehensive consumer research, established informed by global standards on labelling (e.g. ISEAL) and is broadly accepted across the industry in our market, as exemplified by the 160 investment products now certified across 60 organisations including 54 Certified investment products available in New Zealand from 16 issuers - AMP Capital, Australian Ethical, BNP Paribas, BetaShares, Booster, KiwiWealth, MAS, Mercer, Morphic, Nanuk, Pathfinder, Pengana Capital, Perpetual, Russell Investments, Stewart Investors, Vanguard. NZ Superfund has also been certified under the RI Certification Program.

This RI Certification Program articulates the basis of the key features that make a financial product a responsible investment (an umbrella term for the seven sub styles of investing5 - also included at the end of this form[6]). Because of the shear diversity in views on ethics and investing tastes, the Program does not attempt to define, in terms of scope and ambition,

- **ethical** (as does Shariah compliance for Islamic finance) or
- **green** (as may the EU Taxonomy for Green Finance, Climate Bonds Initiative) or
- **impact** (as may the Global Impact Investment Network (GIIN) through IRIS or UNDP in its SDG Impact Practice Standards).

However, it's ever-important (for the consumer protection and the continued growth of the responsible investing industry) that issuers of financial products labelled, green, ethical or responsible, do not submit to puffery or exaggeration[7] and therefore, aside from the features of the products themselves (as stated at **1a**, **2**, **3**, **4** and **5c**

[2] See GSIA (2018) Global Sustainable Investment Review 2018, sustainable investment definitions, p7
[3] https://responsibleinvestment.org/what-is-ri/ri-explained/#spectrum
[4] https://responsibleinvestment.org/program-overview/
[5] See GSIA (2018) Global Sustainable Investment Review 2018, sustainable investment definitions, p7
[6] **A note on definitions**: in 2012 the GSIA published its global standard for sustainable investing, a classification system of sorts. The organisation, of which RIAA is a member, has a program of work tasked with updating the definitions to reflect a change in industry and consumer norms and behaviours. The Principles for Responsible Investment and other such standards-setting agencies use the GISA definitions to underpin their programs of work. RIAA's own RI Certification Program includes slightly amended version of the definitions to reflect some key differences in the New Zealand and Australian marketplaces. The update to the GSIA sustainable investment definitions, which is being led by RIAA, is due to conclude in 2020.
[7] See RIAA (2019) *RI Certification Program Standard and draft Guidance*, Honest claims, appropriate labelling and Sustainability claims pp34-37 and Sustainability Claims, October pp37-40

below), there are *behavioural factors* that the FMA may wish to consider in defining "key features of responsible financial products".

RIAA's RI Certification Program Standard and Guidance[8] steps out what product issuers must have in place:

- Broad financial and legal operating standards
- Reliable governance
- Minimum product and service inclusions
- Relevant and accessible disclosures
- Performance or behavioural commitments

Specifically, and consistent with the RI Certification Program Standard[9], the key features of these financial products are[10] that financial products trading as responsible, green, ethical, sustainable etc.:

1. **Have formal, consistent, documented, and auditable RI strategies and processes: RI Strategies:**
    a. are fully explained in legal product documentation such as the Product Disclosure Statement (retail), Information Memorandum or Pitch book (wholesale) and/or equivalent documentation that supports the product[11], and
    b. are consistently and reliably represented between the legal documentation, supplementary materials, website and other public platforms, and
    c. are underpinned by detailed, fit-for-purpose and formalized RI processes, management systems and reporting frameworks and thereby consistently and reliably applied to the Product, and
    d. subjected to independent verification by a third party, such as required by RIAA's RI Certification Program.
2. **Make honest claims and are appropriately labelled**:
    a. are named to accurately reflect the social, environmental, sustainability and/or ethical outcomes or responsible investment strategy applied to the product and
    b. describe what could be reasonably expected by an investor in terms of the portfolio holdings of the product as well as
    c. ensure all claims made about the product are honest and not false or misleading nor include puffery, un-substantiations and unqualified predictions; and
3. **Avoid significant harm**: can detail how the responsible investment product strategy results in a product for investors that, as a minimum *avoids significant harm* such as for example reflecting the norms of the market place and excluding direct holdings in controversial weapons manufacturers and distributors, whale meat, tobacco producers and fossil fuel reserves; and
4. **Account for ESG factors in the investment process:** can evidence how the responsible investment strategy accounts for the explicit inclusion of environmental, social and governance factors in its systematic
    - selection, retention and realisation of assets, and/or
    - construction of portfolios and/or
    - risk assessment and management and/or
    - selection, assessment and management of managers; and

5. **Have relevant and accessible RI disclosures:** publish
    a. (as is the requirement for registered KiwiSaver products) the details of their product's portfolio holdings (for equities funds, or an equivalent disclosure for other products) on the fund's website, or publicly accessible register
    b. activities and outcomes from stewardship practices (both engagement and voting) and

[8] https://responsibleinvestment.org/wp-content/uploads/2019/10/RI-Certification-Symbol-Standard-and-draft-Guidance.pdf
[9] https://responsibleinvestment.org/wp-content/uploads/2019/07/RI-Certification-Program-Standard-July-1-2019-1.pdf
[10] Ibid p20
[11] Fully explained refers in part to the explicit articulation of thresholds applied to exclusions and inclusions – being quantitative, consistently and clearly expressed.

c. for products asserting certain sustainability outcomes or claims, the product's social, environmental and/or sustainability performance against benchmarks, goals or targets, at least annually as well as the methodology for measuring the Product's contribution to social, environmental and/or sustainability outcomes and
d. if the Product uses short-selling in the pursuit of its responsible investment strategy, how such instruments are managed, the proportion of the product likely subject to short-selling; and on a *look through* basis, all underlying positions including those to which there is zero net exposure after consideration of short-selling (or any other mitigating strategy).

The RI Certification Program references relevant New Zealand and Australia laws[12] that when adequately administered, protect consumers from greenwashing, impact-washing, SDG-washing etc. It is because of these existing laws that RIAA can model its Program to allow the issuer flexibility to market its responsible financial product, but within the strict bounds provided by the Program Standard. This flexibility is key to supporting an evolving marketplace, given the rapidly changing nature of and appetite for responsible investing. Definitions and standards need to be updated to keep in-step with changing norms, community expectations and industry innovation.

An example of this flexibility in action arose from consumer and industry focus groups in New Zealand and Australia held in early 2019 which revealed that ethically-minded investors (current or intending) strongly believe that issuers of financial products labelled 'responsible' also need to possess certain organisation-wide behavioural features in order for the products themselves to be credibly marketed. Specifically, consumers said (and these factors are now built into the RI Certification Program v2.0) that ***issuers*** of responsible investment products[13]:

6. **Are active stewards:** can detail the stewardship practices applied to the management of the responsible investment product and articulate the improved investee governance outcomes of these practices; and
7. **Are organisations with a formalized commitment to responsible investing:** managing or issuing organisations can demonstrate their organisation-wide commitment to promote, advocate for or support approaches to responsible investment that align capital with achieving a healthy and sustainable society, environment and economy (or is working towards this); and
8. **Provide educational information to members and customers** about responsible investment strategies and investment outcomes and generally support the promulgation of financial literacy and capability among the broader community.

Certain marketplace initiatives already exist defining the scope, ambition and pace of environmental or social objectives within financial products labelled thus. The FMA could potentially reference these in any future Guidance provided. These include but are not limited to:

- Climate Bonds Initiative, Global
- Verified Tobacco-free Portfolio, Global
- French Energy and Ecological Transition for the Climate Label, France
- Sustainable Finance Products Quality Standard, Belgium
- forthcoming EU Taxonomy for Green Finance, EU.

RIAA can provide a fuller list to the FMA upon request.

A key development worth noting is that RIAA seeks to introduce a star ratings system early 2020 which will build on the existing Certification Program and enable consumers to differentiate products based on:

12 In Australia: ACCC's guidance on Green Marketing and Australian Consumer Law and/or for New Zealand the Financial Market Conduct (FMC) Act, Part 2, Consumer Guarantees Act, Fair Trading Act

13 The factors listed (1 – 8) are exactly overlaid for equity-style investing. However due to the style and/or structure of a financial product, these factors may not be relevant to all styles (such as short-selling disclosures for green bonds).

1. QUALITY PROCESS: The overall quality of how they operate their process and reliably deliver the responsible investment strategy applied to the product; and
2. REAL OUTCOMES: The extent of sustainability and social outcomes delivered by the product

Done well, the operationalization of 2. above should provide a useful tool for helping remove the ambiguity surrounding current environmental and social product-related claims and act as a treatment over the risk posed by mis-labelled products and resulting in green, impact or SDG-washing.

RIAA invites and encourages the FMA to participate in this standards-setting process over December 2019 and January 2020.

2. *What are the key risks associated with green, ethical or otherwise responsible investment product?*

The concept of risk occurs in each context
The question of risk is one that needs to be considered in the context of the investor and the investor's own risk appetite as well as their investment objectives. Speaking broadly, we understand that the FMA would be supportive of investment that provides stability to the finance system and the economy more broadly. It follows that a longer-term investment horizon, a general characteristic of responsible investing, is consistent with this objective.

Upside risk supported by longitudinal evidence showing responsible investments do as well if not better in terms of returns for investors, especially over the longer term
As mentioned in the submission by RIAA member Pie Fund Management Limited,

> ESG risks are not 'other' risks. If a risk does not have a financial dimension then, for an investor, it is not a risk. Rather, ESG risks are financial risks which may take time or closer examination to reveal (climate change and child labour in supply chains are examples of each, respectively).
>
> Accordingly, there is a strengthening view that not considering ESG is inconsistent with fiduciary obligations, leading to, for example, stranded assets (in relation to climate change). APRA has recently made this case explicitly and directly to Australian company directors in respect of climate change being 'material, foreseeable and actionable now[14]' with clear implications for director liability.

RIAA's RI Benchmark NZ[15] report shows that the systematic and explicit consideration of ESG factors alongside traditional financial data in investment decision making provides better risk adjusted returns, especially over the longer-term because factors such as reputational risk (for example due to systematic corruption) are borne in the valuation of the underlying stock. The same report for 2019 supports this to be true for responsible investments classified by RIAA as core – i.e. financial products that apply some sort of screening (capital allocation) aspects to them.

We recommend this report to the FMA to see the 1, 3, 5- and 10-year performance of RI funds.

We recommend the FMA considers RIAA's submission to the MBIE's inquiry into Default KiwiSaver[16] which provides a global dossier of evidence demonstrates ESG integration delivers stronger risk-adjusted returns and better member outcomes (box 1 which commences on page 4).

Theoretical downside risk due to portfolio concentration
In the case of financial products that apply exclusions, there is a widely held view that downside risk increases due to a concentration in the number and range of stocks in the portfolio. However as mentioned above, by excluding companies that participate in increasingly socially or environmentally marginal activities (such as brown-coal mining), usually comes upside risk management, such as for example, not holding potentially stranded assets (such as brown coal mines).

Downside risk due to inadequate advice-providing requirements and capabilities
In the case of impact investing, a style of investing that straddles both market return and concessional return expectations (see RIAA's RI spectrum[17]), there is a potential for lesser direct financial return due to the intentional pursuit of greater sustainability or social outcomes/returns. Technically this concessional return is only a risk to customers if the financial advisor does not seek to fully understand the client's risk appetite and ethical/impact investing interests; and are not able to provide appropriate information about the risks so the client can make a free, prior and informed choice to accepting the possible concessional direct financial return from the impact investment.

14 https://www.apra.gov.au/media-centre/media-releases/apra-step-scrutiny-climate-risks-after-releasing-survey-results
15 https://responsibleinvestment.org/wp-content/uploads/2019/07/Responsible-Investment-Benchmark-Report-NZ-2019.pdf
16 RIAA's submission to the MBIE's inquiry into Default KiwiSaver
17 https://responsibleinvestment.org/what-is-ri/ri-explained/#spectrum

RIAA commends the FMA to a recent change to the Australian Corporations Act around the provision of financial advice which comes into for January 1, 2020 – the FASEA Code of Ethics[18].

RIAA's submission to the MBIE's Code Working Group on April 30, 2018 regarding the Code of Professional Conduct for Financial Advice Services can be provided upon request.

Downside market risk related to puffery, misleading and un-substantiated claims
Aside from the perceived risk – upside or downside – for investing responsibly, and as the FMA points out, there is some marketplace risk associated with current marketing practices of various styles of responsible investing products.

This is particularly true for ESG integration-only funds that likely include holdings of 'non-ethical companies' (such as oil and gas, tobacco etc.) that may confuse and potentially mislead ethically-minded investors.

Similarly there is an increasing number of products coming to market that make aspirational or general sustainability-related claims (known as impact-washing or SDG-washing) and if not substantiated through appropriate disclosure of assumptions, on-going measurement and reporting against these claims, then this poses a credibility risk on the responsible investing sector more broadly. Specifically, investors lose, or never form trust in responsible / green products and does not participate in that part of the market.

[18] FASEA Code of Ethics legislation https://www.legislation.gov.au/Details/F2019L00117
Explanatory Statement https://www.legislation.gov.au/Details/F2019L00117/Explanatory%20Statement/Text
Guidance Notes (see page 28) https://www.fasea.gov.au/wp-content/uploads/2019/10/FASEA-Financial-Planners-and-Advisers-Code-of-Ethics-2019-Guidance-1.pdf

3. Which certifications, standards or sector exclusion lists do you think are appropriate for green ethical or otherwise responsible investment product?

Certifications and Standards

RIAA's RI Certification Program is the longest-running and widely used of its kind in New Zealand and Australia with 16 organisations certifying 54 funds offered to New Zealand investors.

Given the significant capture by RIAA's RI Certification Program of responsible investment products in New Zealand, RIAA recommends the Program to FMA for the basis of its own guidance[19].

Sector exclusions

In relation to exclusions list, as per RIAA's submission to the MBIE's inquiry into Default KiwiSaver[20], if the FMA is considering recommending a minimum list of exclusions (as does RIAA's RI Certification Program through Product Standard 7 *Avoiding significant harm*), then this would be a small number only (see risks above) and should reflect:

1. universally accepted harmful industries, based on those industries that contravene New Zealand laws or international conventions that New Zealand has ratified. These should include mandatory exclusions that as a minimum include nuclear explosive devices, cluster munitions, anti-personnel landmines, whaling and tobacco as well as certain weapons as recently legislated by the government.

   the New Zealand Government's commitment to the Paris Agreement, and the subsequent Zero Carbon Act providing the implementation pathway. This could be achieved by providers being required to have in place a portfolio-level objective for reducing carbon emission intensity at a pace that aligns with a 1.5-degree Paris target or excluding certain fossil fuel activities from portfolios (heavy emitters and/or fossil fuel reserves)

2. the general, normative sentiment of New Zealanders of the day (i.e. should be reviewed against this standard at least every five years). Example companies engaged in systematic cruelty to animals, or pollution in air and water etc.

Several New Zealand-domiciled actors survey consumers about these issues every year; largely the results correlate. These include, but are not limited to Mindful Money, RIAA and KiwiWealth.

Furthermore, the work by NZ Super and their list of exclusions which is published annually already acts as a proxy for many Certified responsible investment products trading in Australia and could also be considered by FMA as a useful starting point.

[19] See http://www.responsiblereturns.co.nz, for 54 Certified investment products available in New Zealand from 16 issuers - AMP Capital, Australian Ethical, BNP Paribas, BetaShares, Booster, KiwiWealth, MAS, Mercer, Morphic, Nanuk, Pathfinder, Pengana Capital, Perpetual, Russell Investments, Stewart Investors, Vanguard. NZ Superfund has also been certified under the RI Certification Program.
[20] https://responsibleinvestment.org/wp-content/uploads/2019/10/RIAA-Submission-Default-KiwiSaver-Sept-2019-FINAL.pdf

4. *What should disclosure for a responsible investment product include? How will this ensure investors are not misled about the nature, characteristics or sustainability for purpose of a responsible investment product?*

What should disclosure for a responsible investment product include?

As in our response at question 1, we refer the FMA to the RI Certification Program for what disclosures for responsible investments include. In sum the disclosures should include:

1. Truthful product name (not misleading when compared to the holdings therein)
2. Holdings (full holdings, look through to individual holdings level)
3. Fund managers (where externally managed)
4. RI process applied, including the thresholds applied to any exclusionary or positive screening (example, negative screens, best-in-class or controversy screening)
5. Real-world outcomes for any sustainability related claims, including any from stewardship activities, at least annually (e.g. for a claim that an investment reduces inequality, the assumptions, methodology, measurement and results showing how this portfolio has delivered this)

With respect to the RI Certification Program, the following aspects are directly relevant to disclosures and should be considered for inclusion in the FMA guidance.

1. **Have relevant and accessible RI disclosures:** publish
    a. (as is the requirement for registered KiwiSaver products) the details of their product's portfolio holdings (for equities funds, or an equivalent disclosure for other products) including a look through to underlying holdings for products such as pooled investment funds, on the fund's website, or publicly accessible register
    b. activities and outcomes from stewardship practices (both engagement and voting) and
2. **Have formal, consistent, documented, and auditable RI strategies and processes: RI Strategies:**
    a. <u>are fully explained in legal product documentation</u> such as the Product Disclosure Statement (retail), Information Memorandum or Pitch book (wholesale) and/or equivalent documentation that supports the product, , including the thresholds applied to any exclusionary or positive screening (example, negative screens, best-in-class or controversy screening) and
    b. <u>are consistently and reliably represented</u> between the legal documentation, supplementary materials, website and other public platforms, and
3. **Make honest claims and are appropriately labelled**:
    c. are named (product label) to accurately reflect the social, environmental, sustainability and/or ethical outcomes or responsible investment strategy applied to the product and
    d. describe what could be reasonably expected by an investor in terms of the portfolio holdings of the product as well as
    e. ensure all claims made about the product are honest and not false or misleading nor include puffery, un-substantiations and unqualified predictions; and

    f. for products asserting certain sustainability outcomes or claims, the product's social, environmental and/or sustainability performance against benchmarks, goals or targets, at least annually as well as the methodology for measuring the Product's contribution to social, environmental and/or sustainability outcomes and
    g. if the Product uses short-selling in the pursuit of its responsible investment strategy, how such instruments are managed, the proportion of the product likely subject to short-selling; and on a *look*

through basis, all underlying positions including those to which there is zero net exposure after consideration of short-selling (or any other mitigating strategy).

How will this ensure investors are not misled about the nature, characteristics or sustainability for purpose of a responsible investment product?

RIAA's RI Certification Program Standards should be adopted in New Zealand for all products that choose to trade with sustainability-related claims.

This should also include that responsible, ethical and green labelled products be subjected to independent verification by a third party, such as required by RIAA's RI Certification Program.

Also, worth noting is that RIAA seeks to introduce a star ratings system early 2020 which will build on the existing Certification Program and enable consumers to differentiate products based on

1. The overall quality of how they operate their process and deliver the product; and
2. The extent of sustainability and social outcomes delivered by the investment

Done well, the operationalization of 2. above should provide a useful tool for helping remove the ambiguity surrounding current environmental and social product-related claims and act as a treatment over the risk posed by mis-labelled products and resulting in green, impact or SDG-washing.

5. What are the key questions an investor should ask about responsible investment products?

Possible questions to ask Managers of Responsible Investment Products:

1. What is the investment belief that underpins the investment strategy, specifically as it relates to ESG, responsible or ethical aspects of the strategy?
2. What is the RI strategy – how does the RI strategy set this product aside from a traditional one focused only on making returns?
3. To what extent does the manager take ESG issues into account in their investment process? What evidence does the manager have to show that ESG has fed through to investment ideas?
4. What, if any sectors or practices are excluded, how are the exclusions defined and what is the source of information?
5. How often is the portfolio rebalanced?
6. How does the manager engage with companies in their investment portfolios? How are these engagements reflected in the portfolios? What evidence is there that they are raising standards?
7. Does the fund have a focus on including companies with higher sustainability standards or sectors associated with sustainability?
8. What positive impact companies or bonds are included in the portfolio and what are the anticipated benefits?
9. How does the manager report on environmental, social and governance indicators and sustainability outcomes?
10. On which, if any, industry standards, certifications or frameworks, etc. does the manager rely to monitor, assess and/or report on its responsible investing process and outcomes?
11. How does the manager assess the impact of climate change on existing and new investments and how is this communicated to members?
12. What additional risk or opportunities does this add to the returns?
13. Does the Fund Manager publish a sustainability report in respect of its own business activities?

6. ***What due diligence and governance arrangements should be in place to support green, ethical or responsible investment objectives:***
    a. ***For an issuer of green, ethical or responsible investment products?***
    b. ***For a MIS manager investing in green, ethical or responsible investment products?***

A) DD and governance arrangements for an issuer of green, ethical or responsible investment products, including MIS managers as issuers of ESG funds?

RIAA's RI Certification Program Checklist[21] contains the due diligence steps to be taken. Refer to pages 63-73.

B) DD and governance arrangements for a MIS manager investing in green, ethical or responsible investment products?

RIAA's RI Certification Program Checklist (pp 64-73) and Guidance contains the due diligence steps to be taken and is based largely on the Principles for Responsible Investment's guidance on Manager selection, assessment and management (SAM) module for transparency reporting and assessment.

A manager, investing on behalf of a client, has the responsibility to have in place formal, reliable and replicable processes that can deliver to the client a green, ethical or responsible investment strategy consistent with the label of the product. Accordingly, any product managers are to be managed as a supplier in any other value chain. Refer specifically to Drawing on the Standards in RIAA's RI Certification Program.

RIAA notes that, especially in the case where the MIS Manager has invested client money in passive funds, the same level of due diligence (as would occur with an active manager) need apply over the index provider and the mirroring of the index by the manager. In the selection and assessment of index providers Managers should ask to see and understand the assumptions and calculations used (include weightings) to ensure that strategies are not inconsistent with the promise made to consumers. Equally, the Manager needs to have in place its own first and second lines of defense in order to test the accuracy of index providers to offer an index that produces holdings not in consistent with the responsible investment (exclusionary for example) strategies applied.

We refer to the FMA to RI Certification Standard and Guidelines, p65 for Items 1c and 1d, noting the use specific requirements around controls expected around the use of passive indices.

21 https://responsibleinvestment.org/wp-content/uploads/2019/10/RI-Certification-Symbol-Standard-and-draft-Guidance.pdf, Checklist on pages 63-73

7. What should be included in a Statement of Investment Policy and Objectives for registered MISs that have green, ethical or responsible funds?

The RI strategies applied to the product should be fully explained. This must include

a. the investment beliefs, objectives and expectations related to RI for the fund

b. an overview of the process applied by the manager to consistently achieve the application of this RI strategy across the fund

c. the RI criteria used in selecting investments and investment managers

   - in the case of screening, the (quantitative) thresholds applied (example, negative screens, best-in-class or controversy screening)

d. how the issuer measures and reports on the responsible / green 'ness' of the product, to prove up that it delivers and has practical impact; so

   - the benchmarks, goals or targets, as well as the methodology for measuring the Product's impact or contribution to social, environmental and/or sustainability outcomes
   - the engagement and voting strategies (as well as if not, why not)

e. If the Product uses short-selling in the pursuit of its responsible investment strategy, how such instruments are managed, the proportion of the product likely subject to short-selling; and on a look through basis, all underlying positions including those to which there is zero net exposure after consideration of short-selling (or any other mitigating strategy).

8. What best practice features should MIS managers include in disclosure to ensure investors properly understand the nature of underlying investments

Speaking specifically to the sustainability and impact areas of the financial product offered

Best practice should include:

- Product labels that are honest, clear and substantiated (must not be inconsistent with what an investor would expect to find in the holdings)
- Clear articulation of the responsible investment strategy applied, including quantitative thresholds for exclusions for example
- Articulation of the commitment investors can expect in terms of frequency and scope of reporting on stewardship outcomes and social and sustainability impacts from this fund
- Comparative information with responsible investment benchmarks
- Procedures for processes such as ESG management and how it is integrated into portfolios
- Analysis of the impact of investment on issues of concern to investors
- Processes for engagement, including how engagement raises standards (with examples) and thresholds for divestment where engagement is not effective

9. ***What other matters should our guidance include to:***

   a. ***Promote and facilitate the further development of the broader responsible investment product market by providing greater clarity about the FMA's expectations; and***

   b. ***Ensure investors have a clear understanding of what they are being offered and the risks involved, and are able to make informed and deliberate choices?***

Promote and facilitate the further development of the broader responsible investment product market by providing greater clarity about the FMA's expectations

1. FMA to include mandated disclosure around approach to responsible investment - in particular, that all offers to retail clients must include disclosure regarding their approach to responsible investing
   - Do they have a policy? If not, why not?
   - If so, what is it?
   - What are the precise thresholds applied consistently across your RI approach such as exclusions?
   - To what extent does the provider use external research?
   - Has their policy been accredited by a third party (e.g. RIAA)?
   - Disclose or explain

   FMA to consider the scope and approach of existing RI Certification Program that is now widely used by leading issuers of responsible investment products in New Zealand, as the basis of new requirement.

   This would bring New Zealand in step with other jurisdictions that see the incorporation of ESG factors in investment decision making as standard practice for fund managers and other asset managers, as well as company Directors and Trustees as part of fiduciary duties.

2. The FMA could consider issuing a guidance note regarding how they should disclose this information. This might include standard description of RI approach (as the GSIA standard) and some guidance on one or two specific areas (like how Managers should describe exclusions to certain sectors – e.g. 0% revenue tolerance, 10% revenue tolerance etc). RIAA has significant experience and its own guidance available to share with the FMA for this task.

Ensure investors have a clear understanding of what they are being offered and the risks involved, and are able to make informed and deliberate choices?

1. The Code of Professional Conduct governing the provision of financial advice, should come in step with international norms and require advisers to seek to understand the ethical or responsible investing interests and needs of clients; equally advisers should be required to be informed and educated about ESG integration and sustainability / impact themed products so they can talk authoritatively and constructively with clients and have Certified products on their approved product lists ready to be included in recommendations provided. RIAA refers to the FMA to the recent moves by the FASEA[22]to revise its Code of Ethics.

2. FMA to consider the provision of specific guidelines (as per Australian Green Consumer Laws) that sets out standards and examples of how to avoid greenwashing. It could be designed to assist the FMA the appropriate administration of the Part 2 of the Act, specifically as it relates to financial products trading from 2020.

22 https://www.fasea.gov.au/code-of-ethics/

3. FMA to consider how its own (MBIE/CFFC) tool Smart Investor reflects the intent and contents of the forthcoming guidance.

FMA to consider (possibly in collaboration with the CFFC) the support of platforms such as Mindful Money and Responsible Returns (a consumer platform operated by the RIAA) to both engage and inform investors about the responsible, ethical and green characteristics and impact of financial products.

Feedback summary –

1. There are existing definitions, processes and programs in place that could be drawn upon and amplified rather than FMA creating new or varying guidance. Particularly the GSIA definitions around sustainable and responsible investing; and RIAA's Responsible Investment Certification Program Standards and Guidance for behaviours and disclosures for responsible investments.

2. RIAA is a knowledgeable, connected and willing partner of FMA. Areas where RIAA is currently undertaking work and where we invite a more strategic dialogue with the FMA as these areas unfold: we are

   - Working with our global peers on the issue of RI definition standardisation, principally through our project lead on this task with the Global Sustainable Investment Alliance, commencing March 2020, to further strengthen global definitions of RI strategies;
   - Introducing star ratings over responsible investment products from March 2020 seeking to articulate both the quality of the investment process and the social/environmental real-world outcomes of the product
   - building on this work in our policy activities including the Sustainable Finance Forum.